

## A Shallow Harbor and a Cold Horizon: The Deceptive Promise of Modern Agency Law for the Theory of the Firm

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### I. INTRODUCTION

For at least a hundred years, legal scholars have sought a “theory of the firm,” some sort of theoretical account of the corporation.<sup>1</sup> Scholars continue to write about the nature of the business corporation, and conferences such as this one continue to be held, so perhaps an adequate theory has proven elusive. Or perhaps professors produce texts because that is what professors do. And maybe periodic reconsideration of core questions is the way an academic discipline renews itself, i.e., legitimates the next generation, without redefining itself altogether. But rather than understand this perennial need for a theory of the firm as intellectual work that needs to be done (because our forebears did not solve the problem), or in terms of the sociology of the profession, I want to explore a dominant account of the firm as a symptom of political anxiety.

Modern agency law—the consensual agreement of one person to work for and under the control of another—has been widely used to provide a general framework for understanding a great deal of business law.<sup>2</sup> Agency law concepts can be used to frame pedagogical, scholarly, institutional, and even political discourses. In so doing, modern agency law addresses concerns about the institution of the corporation, generally by reference to contract: institutions are created out of essentially consensual, and hence justifiable, relationships among autonomous individuals.

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1. John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655, 655–73 (1926).

2. See, e.g., DAVID G. EPSTEIN ET AL., BUSINESS STRUCTURES (3rd ed. 2010); WILLIAM A. KLEIN ET AL., BUSINESS ASSOCIATIONS, CASES AND MATERIALS ON AGENCY, PARTNERSHIPS, AND CORPORATIONS (7th ed. 2010); ALAN PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH (2009).

So modern agency law is more than a “theory” of the firm in the narrow sense of theory; modern agency law provides a liberal myth or ideology for business associations.

As discussed below, the effort to establish the firm on the bedrock of modern agency law is serviceable for many social purposes, notably classroom teaching, but falls short in at least two ways. First, key corporate relations can be translated into agency law only by squinting in dim light. Second, agency law cannot really be understood solely in terms of consent. The problems with status and hierarchy found in the corporation are replicated in agency law, which used to be discussed more candidly in terms of master and servant. So while modern agency law provides a handy language for articulating much of corporate life, it does not allay the anxieties with which we seek a theory of the firm. Our theory is shallow.

A less than gentle reader might ask: But so what? Why should modern agency law, of all things, be taken so seriously? Much of what follows in the remainder of this Essay is familiar, at least to law professors. Doctrinal structures are subjected to logical pressure that they cannot bear; contradictions emerge, and the author declares victory. But this is only a “victory” for thought under the strange assumption that agency law—or corporation law—is or should be highly intellectually consistent. While perhaps convenient for job talks, the idea that law is consistent has not been serious since Aeschylus.<sup>3</sup> The structure of law is tragic; the law’s commitments are conflicted. Why, then, dwell on these relatively trivial difficulties with modern agency law’s apology for the firm? Why engage in extenuated doctrinal logic and close reading of old cases to debunk modern agency law? The vocabulary and grammar of agency law works well enough for teaching, policy discourse, and a rough and ready understanding of corporate law. Why be impolite?

If this less than gentle reader were in a mood not just to attack the text but also to take its author to the mat, it might be said that while the present Essay argues that anxiety is the mother of theory, surely anxiety has more than one child? Does not the sort of impolite critique undertaken here at least suggest the author’s anxiety, or anger, or hope for something else—some emotion aroused by the misuse of agency law doctrine?<sup>4</sup> Otherwise, why does the author simply not accept the apology

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3. See AESCHYLUS, *THE EUMENIDES* (Hugh Lloyd-Jones trans., Prentice-Hall, Inc. 1970) (458 B.C.E.).

4. A digression must be relegated to the notes. In the case of a job talk, or more generally the young and ambitious, one might think the turn to theory, or criticism of theory, was motivated by ambition rather than anxiety. But ambition is not necessarily free of anxiety, the fear of not making

made by agency law for the modern business corporation, inadequate as it is? Ad hominem, perhaps, but on the mark nonetheless.

One might begin to respond to this attack by noting that understanding the corporation in the essentially contractual and therefore individualistic terms of modern agency amounts to an intellectual avoidance of the social. Within the firm, modern agency law understands relations in terms of contract (Cardozo's "morals of the marketplace") rather than in terms of obligations imposed by society as an attribute of status, as a fiduciary or otherwise.<sup>5</sup> In the world at large, modern agency law paints the firm as essentially private rather than public, as having more liberty interest than social purpose. Under such conceptual conditions, building a more sensible capitalism is hard to imagine.

This Essay argues that a more candid understanding of agency, in which social role and even power are explicitly acknowledged, might enable us to think in more sophisticated terms about the nature of corporate life and what society may hope from corporations. Part II discusses the impulse to define the firm in order to address worries about corporations. Part III examines the centrality of modern agency law for contemporary corporate law discourse. Part IV asserts that modern agency law, based on and legitimated by consent, does a poor job of accounting for corporate, or even simple agency, relations. Agency law therefore cannot serve as the basis for a robust theory, that is, legitimation, of the firm. Finally, this Essay concludes by suggesting how a more candid understanding of agency might help us think about corporate life in terms of business purpose, which might provide purchase for efforts to think seriously about markets, and perhaps even political economy.

## II. WHY DOES THE FIRM NEED A THEORY?

It is not immediately obvious why a theory of the firm has been so long and so widely felt to be required. Indeed, it is not clear what sort of account could possibly satisfy the desire for a theory. Surely any imaginable theory of the firm would be founded on similarly vague concepts like "transaction costs" or "capital structure" or even "agency." The papers in this issue of the *Seattle University Law Review* were occasioned by a very good conference, Berle III. But for all its merit, Berle III did not deliver a theory of the firm that resolves the question and satisfies the

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one's mark, the need to overthrow the fathers (the anxiety of influence), and the like. Those things said, and despite what I have said in the text, I do not want to foreclose the possibility of thought distinct from fear.

5. See *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

desire. The question remains open, and future conferences on the matter will be held.

But as William James pointed out in a somewhat different context, treating social phenomena as propositions and evaluating their validity (the tendency of a certain sort of philosopher) may not be wise.<sup>6</sup> Some things merely *are*, and thus should be understood as opposed to confirmed or denied. James was talking about religious experience, and corporate law scholarship (indeed law and society scholarship generally) could do worse than taking the sort of pragmatic turn that James counseled for the philosophical consideration of religious experience. At the same time, it is interesting—and I think James would have found it interesting—that some social phenomena seem to call for articulation in terms of social principles that are somehow felt to be fundamental. The “firm” is one such idea; “human dignity” is another.<sup>7</sup> But the turn to ontology is hardly an everyday occurrence in American life, so what are we to make of the varieties of ontological desire, as it were? Why pursue theories of the firm?

One might think that a theory of the firm would be helpful to students who are trying to figure out what a corporation is. As discussed below, agency law is indeed useful for tying together much of the basic course on business associations. Yet, while theory has its uses in the classroom, our students come to the legal academy informally knowing what corporations are, for the simple reason that our students, too, live in a commercial society. And students do not graduate (nor should they graduate) thinking they “know” what the corporation is in any fundamentally different way. The legal academy has few if any new answers. It is true that the professoriate has numerous ways to characterize the corporation, and the professoriate continues to hold conferences where, with luck, new and clever things will be said. But the legal academy’s theorizations of the firm are essentially incomplete, multivalent, overlapping articulations of existing social commitments—and that is the point: to sophisticate what is thought about the firm. Doctrinal theorizations of the firm are (and ought to be) refinements of preexisting social understandings. Legal theory *articulates* the social; it does not replace the social with something else. After all, in business associations and other classes, what we teach is the law of the society of which almost all of our students are members.

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6. See generally WILLIAM JAMES, *THE VARIETIES OF RELIGIOUS EXPERIENCE* (1902).

7. See Mary Ann Glendon, *The Bearable Lightness of Dignity*, *FIRST THINGS*, May 2011, at 41, available at <http://www.firstthings.com/article/2011/04/the-bearable-lightness-of-dignity>.

But if we understand legal doctrines to be formalized and often enforceable articulations of the social, and if we perceive that here and in a few other places, doctrine requires the turn to ontology, then maybe the very word “theory,” implying the detachment of the theorist, is misleading. *This* aspect of social life, the firm, is inadequately articulated, and therefore needs a theory; *this* requires some theoretical account and probably a justification. That is, the necessity felt for a theory of the firm, as well as the proliferation of unsatisfying theories, bespeaks a cultural anxiety.<sup>8</sup> Bluntly, we need a theory of the firm because we are worried about the corporation. The not so gentle reader is correct.

Worries about the role of corporations in the United States are certainly at a high-water mark. Specific contemporary examples include the furor over the *Citizens United* decision, Occupy Wall Street and kindred happenings, and the attack on Mitt Romney’s campaign for the Republican nomination for U.S. President by other Republicans, generally a business-friendly lot. The worries underlying such recent issues, however, are neither new nor restricted to populist quarters. Venerable examples of concern about the corporation among leading theorists are not hard to find. For example, in 1937, at the height of Stalin’s power, Ronald Coase wrote:

Those who object to economic planning on the grounds that the problem is solved by price movements can be answered by pointing out that there is planning within our economic system which is quite different from the individual planning mentioned above and which is akin to what is normally called economic planning.<sup>9</sup>

If markets really worked, why were corporations necessary? And if corporations were necessary, was it so obvious that the Soviets were wrong?

In a different but related vein, John Dewey subordinated the endless wrangling over the nature of the firm to the mostly regulatory ends of the theorist: “For the purposes of law the conception of ‘person’ is a legal conception; put roughly, ‘person’ signifies what law makes it signify.”<sup>10</sup> I may multiply examples, but to generalize: the need for a theory of the firm bespeaks not the detachment, but the concerned engagement of the

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8. See *S. Pac. Co. v. Jensen*, 244 U.S. 205, 222 (1917) (Holmes, J., dissenting). While Holmes could be quite acidic about mystical approaches to law (“brooding omnipresence”), he was sensitive to the fact that law’s claims to rationality are limited.

9. R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 387–88 (1937).

10. Dewey, *supra* note 1, at 655.

scholar. True philosophy may begin in wonder,<sup>11</sup> but social criticism—of which legal theory is a branch—begins in worry.

The response to a worry, including that of theorizing, is by nature somewhat defensive. One need look no further than Berle and Means, who begin their magnum opus by talking at great length about the concentration of power in contemporary society:

In its new aspect the corporation is a means whereby the wealth of innumerable individuals has been concentrated into huge aggregates and whereby control over this wealth has been surrendered to a unified direction. The power attendant upon such concentration has brought forth princes of industry, whose position in the community is yet to be defined.<sup>12</sup>

And lest their concern be missed: “As between a political organization of society and an economic organization of society which will be the dominant form?”<sup>13</sup>

Coase is also worried about the power created by the structure of firms, which for him institutionalize coercion (colloquially known as “being the boss”).<sup>14</sup> For Coase, theorizing about firms begins with the observation that in markets, where autonomous actors contract to set price, much business is done by firms, which operate through commands rather than prices. Employment contracts, evidently, are special kinds of contracts:

The contract is one whereby the factor [the employee, a “factor” of production], for a certain remuneration (which may be fixed or fluctuating), agrees to obey the directions of an entrepreneur *within certain limits*. The essence of the contract is that it should only state the limits to the powers of the entrepreneur. Within these limits, he can therefore direct the other factors of production.<sup>15</sup>

But what establishes limits, and why? Coase admits that the answers are noneconomic: “It would be possible for no limits to the power of the entrepreneur to be fixed. This would be voluntary slavery. According to Professor Batt, *The Law of Master and Servant*, p. 18, such a contract would be void and unenforceable.”<sup>16</sup> Thus, for Coase, the logic of

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11. PLATO, *THEAETETUS* 210 (Benjamin Jowett trans., Oxford Univ. 1892) (360 B.C.E.); ARISTOTLE, *METAPHYSICS* (W. D. Ross trans., Oxford Univ. 1924).

12. ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 2, 18–46 (Macmillan 1933) (1932).

13. *Id.* at viii.

14. Coase, *supra* note 9.

15. *Id.*

16. *Id.* at 391 n.2.

the firm entails the possibility of slavery, but agency law sets boundaries to the firm's tendency to dominate.

Agency law is a thin reed and, as discussed below, should not allay the anxieties about corporate power expressed by Berle and Means, or by Coase. At this juncture, it is important to note, however, that while legal theory may not answer, it does a fine job of diagnosing: social anxieties may be traced through the theories we use to articulate, and perhaps justify, reform or otherwise assert control over such institutions. Thus, understanding the move to theory in general terms, theorizing about firms may help people think through the roles corporations ought to play in social life.<sup>17</sup> If the corporation is "this," then people should feel about it "thus"—and law should reflect those beliefs. So to take the infamous recent example of *Citizens United v. FEC*, if the corporation is at the bottom an association of individuals, then perhaps the corporation should enjoy the political speech rights held by such individuals.<sup>18</sup> Or perhaps not.<sup>19</sup>

Whatever the relationship between the modern business corporation and political speech, the point here is that theories of the firm are efforts to name a social phenomenon that is threatening, so the theorist (and by extension, the society that the theorist teaches) can assert a stance toward the firm. As poets, legislators, law professors, and other shamans know, *naming* matters for worship, for the exercise of power, for teaching, for many things. But can naming the corporation as an expression of agency law—and asserting that people, agents, are free—really constrain corporate power and guarantee republican politics (Berle and Means) or the liberty of individuals (Coase)? Unfortunately, no.

### III. AGENCY LAW IN CORPORATE DISCOURSE

Modern agency law concepts run throughout contemporary discourse on the corporation, but they are nowhere more visible than in the basic course on business associations. As already noted, textbooks written for use in business associations tend to start with and go on at great lengths describing agency.<sup>20</sup> Agency concepts may even structure the basic course.<sup>21</sup> Moreover, state bar examiners test agency law doctrines.

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17. For an extended discussion of the corporation in terms of role, see DAVID A. WESTBROOK, *BETWEEN CITIZEN AND STATE: AN INTRODUCTION TO THE CORPORATION* (2008).

18. See *Citizens United v. FEC*, 130 S. Ct. 876 (2010).

19. See David A. Westbrook, *If Not a Commercial Republic? Political Economy in the United States After Citizens United*, 50 U. LOUISVILLE L. REV. 35 (2011).

20. See EPSTEIN ET AL., *supra* note 2.

21. See, e.g., *id.*

As discussed further below, judges, regulators, and scholars routinely discuss corporate behavior and regulation in terms of agency. In short, much corporate discourse is played in the key of modern agency.

*A. The Importance of the “Modern” in Contemporary Agency Law*

“Modern” here means a relation based on individual consent, as opposed to something else.<sup>22</sup> Particularly in the legal context, this use of modern recalls Henry Sumner Maine’s famous statement, and a great deal of progressive ideology since, that “the movement of the progressive societies has hitherto been a movement from Status to Contract.”<sup>23</sup> In this view, the essence of modernity is the contract freely entered into. Conversely, social relations based on something other than contract, such as birth, are archaic.

As articulated most authoritatively by the American Law Institute’s Third Restatement of Agency, contemporary agency law is modern in precisely this sense, in insisting on consent as the foundation of relations. Consider the restatement’s definition of agency:

Agency is the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.<sup>24</sup>

So agency is by definition a matter of consent, and thus presumably a notional equality, in much if not precisely the same way that both parties are bound by contract.<sup>25</sup> Modernizing agency law, to make it seem a matter between consenting adults, has required some creative redescription of ancient relationships. Clever writing aside, agent and principal are not normally thought of in terms of equality. Nor are employer and employee presumed to be peers. And until very recently, agency law used “master” and “servant” as terms of art.<sup>26</sup> So modern notions of agency law are contrasted with ancient or archaic notions around this question of

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22. “Liberal”—in the sense of Kant’s concern for individual autonomy—might be a better word. But as my immediate qualification of “liberal” suggests, the word is now used in so many ways as to be very confusing.

23. HENRY SUMNER MAINE, *ANCIENT LAW* 47–71 (E. P. Dutton & Co. 1917) (1861). In fairness to Maine, he explicitly excludes from “status” those relations, such as employment relations or even marriage, that are the result of agreements.

24. *RESTATEMENT (THIRD) OF AGENCY* § 1.01 (2006).

25. Note that the agency relationship, while consensual, does not require the existence of an enforceable contract, although such a contract, e.g., an employment contract, may be involved.

26. *See* *RESTATEMENT (SECOND) OF AGENCY* § 2 (1958). The Third Restatement of Agency eliminates the terms.



contract: the modern agency relation is understood to be essentially contractual, based on autonomous choice if not always enforceable by a legal document. The archaic relation is based on status.<sup>27</sup>

*B. The Successes of Modern Agency Law as an Approach to the Business Corporation*

There are at least four reasons for the success of modern agency law as an approach to the contemporary firm. First, teaching: agency law, in conjunction with finance, usefully ties together a number of issues in the basic business associations classroom. Second, scholarship: agency provides a fairly technical (and therefore reassuring) jargon with which a number of academic notions may be articulated. Third, institutional hygiene: as already suggested, agency law appears to allay liberal concerns about the relations of hierarchy and status that characterize corporate life, and thus our economy and much of our society. Fourth, political economy: in the same vein as point three, agency law offers a rather comfortable answer for the perennial and loaded question, “What is the corporation?”

1. Teaching

As a loose theory of the firm, modern agency law is at its best in the classroom and has worked well enough for at least a generation of textbooks. The students’ experience of employment—that one tries to “get a job” and an employer may or may not choose to hire—accords with the restatement’s emphasis on the voluntary nature of the transaction.<sup>28</sup> Even more importantly for pedagogical purposes, agency provides a plausible narrative about the emergence of various forms of business associations and allows the teacher to tell a story that logically organizes such associations. A sole proprietorship can only be so big. In order for the business to grow, the owner must hire employees, thereby establishing agency relations. As the business grows, the firm tends to become larger and more structurally complex. Financing needs generate various new relationships, all of which may be described, at least in part, in terms of agency. Thus, agency is an integral part of the orthodox and effective narrative for teaching business associations, in which business opportuni-

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27. See *infra* pp. 1393–96. (discussing *Kidd v. Thomas A. Edison, Inc.*, 239 F. 405 (S.D.N.Y. 1917)).

28. As I point out to my students, they already know most of the social relations articulated by agency law doctrines. The vast majority of law students have been employees, and they interact with employees in their retail dealings. From such experience, students come to class with a rough and ready understanding of who is responsible, and so, in the eyes of the law, liable.

ties require financing, and financing creates an organizational structure that is legally defined and enforced. Agency then is the principle of operational extension—delegation of legal authority combined with oversight—that allows us to think about very large businesses and very small businesses on much the same terms. But whether this principle is wise is another question.

In recent years, business law professors have tried to make their classes more attuned to actual legal practice and, in particular, to transactional work. Agency law is useful to this pedagogical effort, because agency articulates a set of problems that transactional lawyers regularly confront in practice: who is authorized to bind a firm, and what language counts as legally binding, thereby transferring risks? Insofar as law is the mysterious mediating link between mere words and social action, e.g., the transfer of title, the quality of the words spoken matter a great deal. So lawyers have to cope with the question of whether this person's signature binds this rather diffuse institution, which we discuss in terms of authorization of the agent.

## 2. Scholarship

Agency is also appealing to legal scholars because it provides a language at once familiar and technical with which many aspects of corporate life may be articulated. For example, the "separation of ownership and control" (shareholders own the company but do not run it), said by Berle and Means to characterize the modern business corporation, is now often rephrased as an agency problem: the principals (shareholders) are unable to monitor and control their agents (the management).<sup>29</sup> In particular, the tendency of corporate executives to persuade boards of directors to award enormous "compensation" packages is an agency problem. Commonly proposed responses, such as "say on pay" or securities law disclosure of the details of executive compensation, may be understood as making it easier for principal-shareholders to know what "their" agent-executives are doing.

Indeed, once one accepts the idea that managers are the agents of shareholders, most of the traditional concerns of corporation law may be recast as responses to the agency problem.<sup>30</sup> For example, limited liability: in a world of dispersed shareholders, shareholder principals are not able to monitor all the activities of their agent managers and therefore are

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29. See BERLE & MEANS, *supra* note 12.

30. As discussed below, the technical definitions of agency do not really apply to the corporate relationships, so all of this talk of "agency" has a rather metaphorical quality. See *infra* Part IV.A.

hesitant to enter the agency relation, i.e., to invest. Thus, in order to foster investment, the law establishes limited liability firms of various sorts, thereby cutting off the traditional responsibility of employers for the actions of their employees taken within the scope of employment, *respondeat superior*.

Similarly, boards of directors, with their fiduciary duties, act on behalf of shareholder-principals who cannot be expected to monitor the activities of “their” company, much less organize to take corrective action should a problem arise. Likewise, the default rules of corporate law exist to protect agents who have no opportunity (or rationally do not take time) to negotiate the operating rules of the entity. Indeed, the mandatory disclosure regime that securities laws establish, with its quarterly updating and obligation to notify owners of significant events, helps shareholder-principals keep tabs on their employee-agents.

As a theory, modern agency law may be understood both as a restatement of and a marked improvement on simple “nexus-of-contracts” theories of the firm.<sup>31</sup> Agency law retains the core appeal of contractual approaches to the corporation, namely, the emphasis on consent, and by extension, volunteerism and autonomy. Agency improves on nexus-of-contracts theories, however, in at least three noteworthy respects. First, agency is a *consensual relation* but not a contract. The relation may be established without the knowledge, or even contrary to the intention, of the parties. Agency is not a legal instrument but a loose description of a broad set of relations that, if they are found to exist, impose legal obligations even in the absence of an actual contract. While contractual in nature, agency is thus a broader and more capacious theory than contract.

As lawyers know but economists rarely deeply understand, contracting is difficult, terms are uncertain, default is common, and enforceability is practically unlikely. For present purposes, a relatively small percentage of undertakings—and hence much less than the fabric of business relations—are the sort of judicially enforceable, in-fact promises that lawyers call “contract.” Rephrased, the “contract” in “nexus of contract” is best understood as metaphor. Since agency provides a more capacious category than contract, it is a better term with which to think through and organize business relations.

Second, the agency relationship establishes a business entity distinct from its owner or owners. Even in the minimal case, a sole proprietorship with employees, agency law presumes and incorporates an idea

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31. For the *locus classicus* see, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

of “the business” somewhat alien to bilateral conceptions of contracting. In agency law cases, the idea of the business arises in discussions of the scope of employment, and hence the liability of the principal. This minimal idea of the business—and some degree of an entity theory of the firm—matters not least because of tax law, which generally treats businesses differently from their owners. And jurisprudentially, agency law helps resolve issues surrounding methodological individualism.

Third, and as noted with regard to teaching, once the idea of the business is established, agency law provides a theoretical narrative for corporate governance, including statutory corporate law and fiduciary duties. On this account, it is because agency relationships exist within the corporation that we have corporate law. Grandly, one might understand traditional corporate law as a highly refined form of agency law adapted to life within the firm.

Taken together, agency law does a fair job of relating various concepts, doctrines, and rules that comprise corporate law. For both students and scholars, agency law helps to define and demarcate the field.

### 3. Institutional Hygiene

Politically liberal societies presume that people are autonomous, capable of making choices, and that such autonomy deserves legal protection. People are also assumed to be equal to one another—status is not presumed to be essential. Equals should share in decision-making; thus, liberal societies tend to be democratic. All this is familiar and requires no elaboration.

For such societies, business life is problematic, and the institutional life of the firm particularly so. If it has long been “self-evident” that “all men are created equal,”<sup>32</sup> then why are there bosses? In firms, higher-level workers regularly tell subordinates what to do. Those subordinates may choose to leave the firm, but within the context of the firm, individual choice is rare. Status matters a great deal, and hierarchies abound. Decisions are rarely taken on a democratic basis, and when they are, e.g., shareholder voting, the votes may be pro rata (based on shareholding, property, associated with class) rather than per capita. In short, life within firms is in marked contradiction to liberal ideology.

As noted, Coase’s Theory of the Firm arises from a version of this contradiction between choice and obedience. As Coase put it in an economic idiom, Why do we observe hierarchical relations of command and control within firms, rather than price mechanisms, in which buyers and

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32. *See* THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776).

sellers may choose the price at which they interact? If people are rational, and markets are efficient, then what use are corporations?<sup>33</sup>

Agency presents a partial resolution of this conflict. Agency is based on consent; the agent and the principal choose to enter into the agency relation. In the words of the restatement, agency is a voluntary relation arising from the agent's "assent," or somewhat mysteriously, the agent "otherwise consents."<sup>34</sup> To be sure, the agent assents to act under the "control" of another, but the emphasis is on the voluntary nature of the transaction as a whole—one must volunteer to be controlled.

Paradigmatically, the employer hires an employee. The employer is free to hire someone else or nobody at all. The employee is free to work for someone else, for herself, or not at all. Once made, such choices have consequences, but the fact remains that at least initial choices abound. So why do we observe master-servant relations in the heart of liberal modernity? The standard corporation's answer, sounding in agency, is that employees assent to their status as agents of corporations. Employees signed employment agreements, and therefore are not slaves, wage or otherwise.<sup>35</sup>

#### 4. Political Economy

Agency law gives us a way to explain the existence of groups, societies, and organizations. The corporation is a nexus of contracts, mostly establishing agency relationships. The group is thus merely a convenience; the reality is the individual. Thus is the fear of the social allayed. Agency does this by reenacting the social contract on the corporate scale—it is conventional to analogize the corporate charter to a constitution. Thus, any discomfort that we feel with our culture (that any denizens feel with any imaginable culture, Freud would say),<sup>36</sup> can be met with the contractual narrative: this is the tour we booked.

#### *C. Modern Agency Law as Theory*

As discussed above, modern agency law addresses several problems for prevalent understandings of corporation law. Legal doctrine is used to tie together disparate parts of the basic curriculum and provides a professional vocabulary, thereby helping to comprise the field of corpo-

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33. Coase, *supra* note 9, at 395.

34. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

35. See Coase, *supra* note 9, at 404; see also KARL MARX, WAGE-LABOUR AND CAPITAL (Int'l Publishers 1933) (1847).

36. See SIGMUND FREUD, CIVILIZATION AND ITS DISCONTENTS (James Strachey trans., W. W. Norton & Co. Inc. 1961) (1929).

rate law. Agency law accounts for things that modern liberals, afraid of class and worried about repression, need to have explained or justified about how business is done. And perhaps most importantly, agency law begins to relate this mysterious social object, “the firm,” to the rest of social life.

The mere recounting of the uses to which agency law is put suggests that “theory” is far too objective and abstract a word. In various contexts, agency law constitutes a narrative, a myth, an ideology, a justification, what anthropologists would call an “imaginary,” and an a priori of certain kinds of mind confronting certain kinds of social structure. The corporation is thought about, explained, taught, and argued over in terms of agency; this says much about thought, including the not entirely rational parts of thought on which abstract theory depends.

The priority of agency in common understandings of the corporation is philosophical or even mythological, but not chronological. Although agency law discourse is ubiquitous, the law of business organizations, even the modern business corporation, is older than modern agency law, founded on consent. In short, corporation law is not historically based on modern agency law. Unsurprisingly then, modern agency law does an awkward job of articulating relationships that in fact arose elsewhere, under the sway of other conceptions. Modern agency law is messy, hence the need for constant restatement; courts frequently get it “wrong,” deciding cases with language quite at odds with whichever restatement is current.<sup>37</sup>

To say that agency law is mythical or ideological is not to debunk agency. Law needs myths, intellectual commitments, structures of justification, and the like. One might ask, however, whether our myths are well-told, our imaginations serviceable. Does modern agency law really perform as claimed? At one level, the question is juvenile. Of course agency law performs. As discussed above, the law articulates delegation more than well enough to structure the first-year course in corporations, gives scholars a language, and apologizes for labor relations and institutions that wield great power. Those are achievements. Nor are agency law’s faults so great. After all, our law is not nearly so doctrinally rigorous as job talks and most law review articles still presume. And surely the revelation of logical inconsistency or sheer silence among doctrines

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37. See, e.g., *Lind v. Shenley Indus., Inc.*, 278 F.2d 79 (3d Cir. 1960) (discussing messiness of terminology); *Menard, Inc. v. Dag-MTI, Inc.*, 726 N.E.2d 1206 (Ind. 2000) (finding “inherent authority” after the restatement had abandoned the term); *Kidd v. Thomas A. Edison Inc.*, 239 F. 405 (S.D.N.Y. 1917).

is not shocking. So, of course agency law performs—every corporate law professor has seen it perform.

Socially adequate performance, however, may not be enough. If we as a profession are sufficiently uncomfortable with corporation law that we attempt to “ground” it on some other social structure, such as agency law, then we might ask whether agency works to explain what we want it to explain. In reducing so much of corporation law to agency law, we must ask whether we have left out something vital. Is agency law not just practical, but satisfying?

The contours of a theory bespeak specific worries. Specifically, at the cost of some redundancy, modern agency law addresses two deep concerns for a commercial society. First, what is the nature of the institutions of commerce, and by extension, how should such institutions be regulated, what rights should they have, and so forth? What should the relationship between the state and the corporation be? Second, what justifies power within the corporation? In particular, what justifies the right of a corporation to control its employees, and conversely, imposes obligations on the corporation for the often wayward acts of employees?

As suggested above, modern agency law provides a rather serviceable set of traditional liberal answers to these questions, at least superficially. From this perspective, the corporation is a business entity; business entities are established according to the principles of agency law; agency law is founded on consent. Working from the bottom up, it might be said that the corporation is a set of consensually entered into agency relations. And surely individuals can contract and delegate powers; agents can conduct business on behalf of others; large institutions can be understood as chains of such delegation. And because agency relationships are believed to be, at their core, consensual, the hierarchical order and raw power found within corporations do not offend liberal commitments to individual autonomy, and we may even speak of the rights of such collectives against the power of the state. Modern agency theories of the firm thus emerge as fundamentally apologetic; such theories appeal to the liberal commitments of a commercial society.

#### IV. MODERN AGENCY LAW FAILS TO ESTABLISH THE FIRM

Myths—or ideologies, if one prefers the secularization—work until they do not. Modern agency law explains corporation law in terms comfortable for political liberals (almost all law professors) only if we do not take modern agency law very seriously on its own terms. This Part will discuss how the effort to establish the firm on the bedrock of modern agency law falls short. First, corporate relations, which are discussed in terms of “agency,” do not really conform to the requirements of modern

agency law. Second, despite the strenuous efforts of the American Law Institute, agency law itself cannot really be founded on truly independent consent. The problems with status and hierarchy found in the corporation are replicated in, rather than solved by, the turn to agency law, which used to be discussed more candidly in terms of master and servant. So while modern agency law provides a handy language for articulating much of corporate life, agency law does not promise a more republican, less authoritarian, theory of the firm. The horizon is cold.

*A. Modern Agency Law Inadequately Articulates  
Corporate Relationships*

Without a principle of delegation, no large enterprises would be possible; owners must be able to delegate authority to run the business to employees. This problem of delegation and thus agency law is found in any business involving more than two persons—regardless of the legal form of the association. To recapitulate the basic course in business associations, one might imagine a sole proprietor who hires a helper to work for him. The sole proprietor is the boss, that is, he expects the helper to work for his benefit (to help him make money) and be subject to his control. The helper agrees so to act. We have no problem recognizing a classic agency relationship here.

Matters get slightly more complicated if a partner hires an employee to work for a partnership. The employee agrees to work for the benefit of the partnership, that is, the business, not the partner as an individual. But partners are co-owners and share rights to manage their partnerships. And other partners are bound by their actions. So we have little problem recognizing that the employee is an agent of the partnership.

In the case of a corporation hiring an employee, however, a doctrinal problem arises. Consider the following: some natural person, “Fred,” applies to work at ABC Corp. Fred signs an employment contract and goes to work, subject to the control and for the benefit of ABC Corp. Thus, Fred is ABC’s agent, and conversely, Fred’s principal is ABC Corp.

But who, in the language of the restatement, “manifest[ed] assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf . . .”?<sup>38</sup> Not ABC Corp., but Sally, the manager of the office where Fred sought work. Fred, however, did not agree to work for the benefit of Sally and subject to her personal control; Fred agreed to work for ABC Corp. The standard employment contract, when the employer is a corpo-

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38. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).



ration, might seem to fall outside the restatement's definition of an agency relation.

The usual, and for most purposes completely serviceable, way to address this problem is to note that Sally too is an agent with the authority to hire and fire employees. Doctrinally speaking, as a manager of ABC Corp., Sally has actual authority to hire people like Fred. So it is Sally who manifests ABC's assent to enter into an agency relationship with Fred.

But how did Sally get this authority? She was hired as an employee of ABC Corp. Her employment contract was signed by "Lois," another manager—a regress is thus established. A corporation cannot "manifest assent" to entry into the agency relation, thereby creating an agent, except through another agent. But that agent needs to have been created too. (And behind me, said the gatekeeper, stands another gatekeeper.)<sup>39</sup> Thus, while it is often said that employees are agents of their employers, and this includes corporations, it is not immediately clear how employees become agents, at least if we take the restatement's definition of agency seriously. Corporation law places delegation, notably hiring—the construction of the business—on a foundation of agency law, but only by assuming agency law.

The regress sketched here is not infinite because a corporation, while perhaps immortal, is not eternal. Every corporation was established by definite people at particular times. At the establishment of a corporation, at the first meeting, the board typically elects senior management, and grants management the authority to hire people. So the CEO hires managers, who hire underlings. Thus, the question becomes, What is the authority for hiring the initial CEO?

In hiring the CEO, the board does not act as agent for the corporation in any strict sense because the corporation, as an operating entity, does not exist yet. Because it does not exist and has no agents, the corporation cannot manifest assent to anything. More simply put, the corporation does not exist as a contracting party until it has been formed.<sup>40</sup> So insofar as agency is understood as a consensual relationship, and presuming that we are comfortable with the idea that an incorporeal institution can consent, consent is not at issue. Instead, in establishing a new corporation, the board has statutory authority to choose management and to delegate much of the board's authority to control the corporation to management.

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39. See FRANZ KAFKA, *THE TRIAL* (Alfred A. Knopf, Inc. 1984) (1925).

40. The nascent corporation, however, can be the object of fiduciary duties.

Assent is not the only reason the establishment of corporate authority cannot be derived from agency. In delegating authority to run the day-to-day operations of the company to managers, including hiring employees, the board acts in the interest of the corporation and its shareholders. That is, the board is not the principal. At the same time, the board does not act “subject to the control” of the corporation and its shareholders. Just the opposite—the corporation is subject to the control of the board. That is, the corporation is not the principal either. Thus, we may say that the CEO serves the corporation, and so is in some sense an agent, but neither the corporation nor the board really meets the doctrinal definition of principal.

The traditional theoretical proposition, of course, is that the shareholder is the principal, and managers (and so presumably employees hired by managers) are agents. Again, this is a fine metaphor, but it hardly stands up to pressure. Shareholders cannot be principals because they have no rights to control the operation of the company. Specifically, they do not hire and fire managers. So if the definition of agent includes a party, the principal who both benefits from and controls the relationship, then shareholders are not principals either. As Berle and Means pointed out, shareholders may be (beneficial) owners of the company, but they do not have rights to control. Indeed, the shareholder is in the position of the beneficiary of the (board’s) trust and thus is hardly a principal.

None of these doctrinal games present difficulties for corporation law in practice. This is a problem only for a legal theory that claims to establish the institution on a foundation of modern agency law and individual consent. In practice, the board’s authority to empower the CEO is unquestioned. There is a ritual for establishing a corporation; so long as the forms are observed and matters are handled in businesslike fashion, the state and others recognize the firm as a legal person with legal powers and obligations. Under ordinary circumstances, nobody questions the authority of the CEO to hire underlings, and underlings to hire ordinary employees. How else would one run a business? Such a person may even be informally understood as the principal in an agency relationship, but this is mostly imagery.

A more rigorous theory of the firm than modern agency doctrine can supply would admit that the corporation’s legal personality is derived from state corporation law with a strong admixture of tradition that recognizes and enforces a trust-like relationship between the board, on one hand, and the company and its shareholders on the other. The state—better, the social—stands at the beginning of corporate life, and, as we shall see, makes its interactions plausible.

So the founding of a corporation is conceptually awkward; beginnings are often awkward. Suppose that we allow the regressions discussed above to be resolved, just once and as a matter of law, by appealing to state corporate law (the social rather than the contractual). Let the board, by operation of state law, hire a CEO for the corporation, and even authorize him to hire employees. After this original lapse—we might say, after we have established effective corporate personality because we have authorized at least one natural person to act in the corporation's name—can we build the rest of corporation law on a foundation of agency law?

No. To see why, start with the question of whether the CEO is an agent as defined by the restatement. The CEO is hired to act “for the benefit of the corporation and its shareholders,” not for the interest of the board.<sup>41</sup> But the board can fire the CEO. Thus, from the CEO's perspective, the “agency” relationship is actually an agreement to act for the benefit of *Y*, but under the control of *X*.

One may address this problem, perhaps, by saying that the procedurally proper action of a duly constituted board, taken in the interest of “the corporation and its shareholders,” is what is meant by a “corporate act.” So the board's resolution hiring the CEO, if taken in good faith, is the action of the corporation. Thus, the CEO is really acting for the benefit of *Y*, always absent, under the control of *X*, whose actions are authoritative because they are deemed to be the actions of *Y*.

By the same token, the manager's hiring of another manager may be understood as the company's manifestation of assent to enter the agency relation. The manager may well retain control over the hiring, but the hiring is supposed to work for the benefit of the company and its shareholders. Again, the employee perceives himself to be working for the benefit of the corporation, whose assent was ostensibly manifested by *X*, who also derives authority from working for *Y*, subject to *Y*'s control. Thus, duly authorized actions of the agents of the corporation are deemed to be “actions of the corporation,” not just at the founding but also every time the board or a manager exercises power.

Asserting that duly authorized actions of agents of the corporation are the actions of the corporation is problematic. As discussed above, agency theories of the firm understand corporation law as a response to agents who do *not* act in the best interests of the firm. The “agency problem” is at the root of boards of directors, securities laws, default provisions in corporate statutes, and so forth. That is, both agency law and

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41. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

corporation law assume that the action of agents is *distinct* from the action of their principals.

To which one might respond, it is only *duly* authorized actions of agents that are authoritative as actions of the firm. Again, this is not a problem in business life, but it is a huge problem for agency theories of the firm. Ordinarily, principals grant agents the authority to act. In the corporate context, however, the principal cannot act; the agent has authority to act by claiming that its action is “duly authorized,” meaning procedurally proper and in furtherance of corporate interests. If such action is indeed deemed “due,” then the agent’s action will be legally authoritative as action of the principal, the corporation. For example, if a duly authorized CEO signs the papers closing a transaction, that is corporate action, the action of the principal. The CEO’s action can be understood to be corporate action—the action of the principal, the corporation and its shareholders—only if the CEO-agent is deemed to be working in the way expected of a CEO, that is, if the agent meets some standards of behavior, usually board authorization. But as discussed above, the board is not the principal. More generally, agency law cannot provide the standards by which CEO behavior is deemed corporate action, simply because the principal—the corporation and its shareholders—is silent.

Rephrased, if agency law could provide the standards for managerial action, most of corporation law would disappear. Either boards and managers would assert that all of their actions were authorized (destroying notions like fiduciary duty), or shareholders would have to enter into real agency agreements, destroying centralized management.

In sum, claims that agency law establishes some sort of bilateral, even personal, relationship between the individual and the corporation do not relieve liberal qualms about corporate hierarchy. The corporation’s powers, including the powers to conclude binding employment agreements, dispose of the assets of shareholders, and the like, simply are not derived from the individual’s contractual power to form agency relationships. By extension, the philosophical or psychological requirements that agency is supposed to address are not met by modern agency law, for the simple reason that modern agency law does not really explain the delegations—the hierarchies—that are at the core of the business corporation.

#### *B. Modern Agency Law Is Not in Fact Based on Consent*

One of the most important things meant by “modern” is the normative claim that social relations are not—or at least should not be—organized by birth. The American and French Revolutions proclaimed

“equality” and banned titles of nobility.<sup>42</sup> Social relations are, in the modern view, to be organized by consent. In the political context, one speaks of a social contract and the consent of the governed. In the legal context, one speaks of replacing a law of persons with a law of contract. Less dramatically, modern agency law is modern precisely insofar as it seeks to substitute contract for status.

As noted, the Third Restatement of Agency expressly defines agency in terms of consent.<sup>43</sup> But the restatement’s effort to establish agency law on the basis of consent extends far beyond the basic definition. The American Law Institute has rewritten the very language of agency in terms more in keeping with a contractual age.<sup>44</sup> The redolent “master and servant” of earlier restatements has been replaced by the anodyne “employer and employee”; the language of dominion has been replaced by the language of the employment contract. Whether this is bureaucratic avoidance, good manners, or mere squeamishness, the question for present purposes is, “Can it work?” Can employment relations, and other business relations for which “agency” putatively provides a principled grammar, be reduced to contractual relations? Can agency law free itself, and by extension the firm, from the social?

One might look also to the definition of apparent authority.<sup>45</sup> When the [principal] manifests to a third party that [the agent] will be acting as agent for the principal, and the [agent] acts in a way that an agent might be reasonably expected to act, then the [principal] is estopped (to use the old language) from denying the third party’s claim that an agency relationship exists. Therefore, the [principal] is liable for the action of the [agent] to the third party, even when no agency relationship actually exists, which is why “principal” and “agent” have been in brackets.<sup>46</sup>

The definition is awkward. The restatement is loath to say that some people simply have the status of principals, and others have the status of agents. From the restatement’s modern perspective, it is what people do that has legal consequences and, in this case, defines them as if they were principals or agents. As a doctrinal matter, legal status—and hence liability—is created by the principal’s holding out the existence of an agency relationship, and the agent’s fulfillment of that role, even if such actions do not amount to assent between the principal and agent

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42. See U.S. CONST. art. I, § 9, cl. 8; THE DECLARATION OF INDEPENDENCE (U.S. 1776); DECLARATION OF THE RIGHTS OF MAN AND OF THE CITIZEN (FR. 1789).

43. See *supra* Part III.A.

44. *Id.*

45. RESTATEMENT (THIRD) OF AGENCY § 2.02 (2006).

46. Once more, with letters: If *A* holds out to *C* that *B* will be acting as his agent, and *B* so acts, then *A* cannot deny liability for *B*’s actions.

themselves. Apparent authority thus has the structure of promissory estoppel.<sup>47</sup> The legal function of such doctrines is to provide for liability even in the absence of an explicit undertaking to accept the risk of loss, i.e., in the absence of an actual agency agreement, or more generally, an actual contract. Apparent authority thus expresses society's insistence on what it believes is right, not the agreement of the parties.<sup>48</sup>

The principal's manifestation to the third party should give rise to liability, even when—as is often the case—the manifestation is incorrect in fact. Recall, procedurally, that the third party *C* is trying to hold *A* liable for *B*'s actions, and that *C* thus alleges an agency relationship between *A* and *B*. *A* will often be in the position of truthfully saying some version of “I told you *B* would do something sensible, not the silly thing for which you are now suing me.” And *A* will also, often truthfully, say, “I didn't tell *B* to do that,” that is, the “agent” was neither acting for my benefit nor subject to my control, and therefore was not acting as my agent. *A* then will claim that he should not be held liable for *B*'s actions. Nonetheless, the law holds *A* vicariously liable for *B*'s actions under theories of apparent authority.

The consequence of imposing liability on dominant parties for the actions of their subordinates is to enforce the stability of existing social relationships. A gentleman is entitled to rely on another gentleman's representation that his man (or his lawyer) will be acting on his behalf. A buyer is entitled to rely on a company's representations when dealing with a company salesman. If the servant-employee acts beyond the scope of his authority, that is the master-employer's problem, not that of the

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47. See the discussion of *Kidd v. Thomas A. Edison, Inc.*, 239 F. 405 (S.D.N.Y. 1917), *infra* pp. 1393–96.

48. As John H. Schlegel reminds me, one might make analogous arguments about the centrality of social understandings, as opposed to the agreement between parties, with regard to quasi-contractual actions. Various causes of action that came to be called “quasi-contract” were founded on restitution and sounded in equity. More generally, the notion that the simple bilateral contract is somehow obvious and foundational—the conception of “contract” presumably used in “nexus of contracts”—is in fact a distinctively modern conceit.

Common law does not even begin to develop a unified law of contract until the fifteenth century, largely out of the action of *assumpsit*, which was never the sole way to get an agreement enforced. Nor can the process of theoretical unification be said to be complete in the twenty-first century, as evidenced by the need for doctrines of reliance, unjust enrichment, and the like to create obligations, to say nothing of various limitations on obligation, regardless of the agreement between the parties. All of this was clearer during the Middle Ages when there was no illusion that promises were generally enforceable. Instead, different kinds of promises, among different kinds of parties, were enforceable or not according to different, often formal, considerations, through different causes of action or other processes, enacted in different courts or other social settings.

Surely, much that happens in today's corporation that is labeled “contractual” is similarly dependent on social understandings as on the autonomous will of the parties. The difficulty arises, however, when we are not so sure that our tradition is right, that our social order is legitimate.

innocent third party who relied not only on the master-employer's representation but also implicitly on the capacity of the master-employer to control his underlings. Tacit recognition of such hierarchical relationships makes corporate manifestations credible, something to rely on when eating in a restaurant or boarding an airplane. Under doctrines of apparent authority, if principals, agents, and third parties (bosses, workers, and customers) all understand and play their roles, courts will enforce such roles by holding the boss liable for the actions of the worker. In light of the centrality of role, that is, social expectation, one cannot understand apparent authority in purely autonomous (asocial) terms.

Agency law's covert solicitude for the social order is undeniable in cases of what used to be called inherent authority and is now less trenchantly called the liability of an undisclosed principal. The classic teaching case is *Watteau v. Fenwick*,<sup>49</sup> as the facts perfectly illustrate the doctrines at issue.

One Humble owned and operated a tavern, the Victoria Hotel.<sup>50</sup> He sold the tavern to a syndicate, including Watteau, without telling anyone.<sup>51</sup> Humble continued to operate the tavern as an agent of the syndicate, and the tavern remained licensed in Humble's name.<sup>52</sup> Under the agency agreement, Humble promised to buy supplies from the syndicate, including cigars and Bovril (a meat syrup).<sup>53</sup> Fenwick was a salesman. He sold Bovril and other forbidden products to Humble on credit.<sup>54</sup> On behalf of the tavern, Humble eventually ran up a substantial bill.<sup>55</sup> When Fenwick tried to collect, Humble was unable to pay.<sup>56</sup> Fenwick sued and the true ownership of the tavern, and Humble's role as agent, emerged.<sup>57</sup>

So the class is asked, Who pays? The salesman or the owners of the tavern whose business after all benefitted from selling the supplies in question? It seems right—and it seemed right to the court—that the owners of the Victoria should pay for supplies used by the tavern.<sup>58</sup>

The problem is doctrinal. Under what legal theory were Watteau and friends liable to their supplier? First, there was no contract between Watteau and Fenwick. Second, Humble had no actual authority to act on

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49. *Watteau v. Fenwick*, [1893] 1 Q.B. 346 (Eng.).

50. *Id.* at 346.

51. *See id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *See id.*

57. *Id.*

58. *Id.* at 348–49.

behalf of the owners to buy Bovril and other products from Fenwick. In fact, Watteau had expressly forbidden such purchases. Third, Humble did not have apparent authority to buy the supplies. Fenwick did not know of Watteau's existence; Watteau made no "manifestation" to Fenwick that Humble was Watteau's agent.<sup>59</sup>

So the court threw up its hands and declared:

[O]nce it is established that the defendant was *the real principal*, the ordinary doctrine as to principal and agent applies—that the principal is liable for all the acts of the agent which are within the authority *usually confided to an agent of that character*, notwithstanding limitations, as between the principal and the agent, put upon that authority.<sup>60</sup>

The court thus announces that the extent of an agent's authority is measured by usual practice (custom, the social), not by the agreement between agent and principal. Buying Bovril is the sort of thing that barkeeps do. The owners cannot escape liability to third parties for such customary activity on the part of their agent, even if the third party did not do business in reliance on his knowledge of the existence of the agency relationship.

Similarly, the court—without discussion at all—presumes that Watteau is the "real principal."<sup>61</sup> Watteau owns the business; he is the boss. This is property, not contract. The court does not look to the agency agreement to determine the extent of Watteau's obligations as principal. In fact, the court ignores the agreement altogether and simply holds Watteau, as the real principal, liable for the actions of his agent.<sup>62</sup> In short, consent has very little to do with Watteau's liability for debts incurred by Humble.

As already suggested, the Third Restatement of Agency attempts to cabin the problem of inherent authority, with its explicit reliance on custom in lieu of consent, to the somewhat unusual circumstance of a third party seeking damages from a hitherto undisclosed principal. In cases where the principal is known, some manifestation can be found, and the case can be decided under the rubric of apparent authority, which may be

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59. The court does not discuss ratification, but the restatement also includes ratification as a source of authority. That is, an action purportedly done as agent for another, but without actual authority, subsequently may be ratified by the other (who becomes a principal). See RESTATEMENT (THIRD) OF AGENCY § 4.01 (2006). At any rate, Watteau and friends do not appear to have ratified Humble's purchases from Fenwick.

60. *Watteau*, 1 Q.B. at 348–49 (emphasis added).

61. *See id.* at 346.

62. *See id.*



thought of as a kind of estoppel, which is almost a contract. In this view, inherent authority is an anomaly, something of an embarrassment to the almost contractual doctrinal structure of agency that articulates the vast majority of cases.

But inherent authority is no anomaly in the otherwise contractual structure of agency law. Agency's skin may be contract, but the social, status, and hierarchy lie not far beneath. Consider Learned Hand's brilliant opinion in *Kidd v. Thomas A. Edison, Inc.*<sup>63</sup> In that case, Mary Carson Kidd, a noted opera singer, sued Edison on a contract for performances.<sup>64</sup> Edison had entered the contract as part of a plan to use Kidd's performances in a marketing campaign for the recently invented phonograph.<sup>65</sup> Edison's contracts with artists like Kidd were negotiated and finalized by an Edison employee, Fuller.<sup>66</sup> Maxwell, Fuller's boss, had given Fuller the authority to make such deals on Edison's behalf, but he had also specified a rather unusual arrangement for booking and payment.<sup>67</sup> In actually negotiating the contract, however, Fuller had not made Edison's position clear, and the engagements were negotiated on terms customary for booking singers.<sup>68</sup> Kidd sued to hold Edison to the terms of the contract that Fuller in fact had made, and the court agreed, enforcing the contract.<sup>69</sup>

Edison appealed, arguing that Fuller did not have authority to make that contract on Edison's behalf.<sup>70</sup> The question on appeal was the scope of Fuller's apparent authority.<sup>71</sup> Arguing along lines already suggested, Judge Learned Hand had no problem finding that Fuller had apparent authority.<sup>72</sup> Edison had held Fuller out as its agent to a third party, Kidd. Fuller had acted like an agent. Edison was now estopped from denying Fuller's authority to bind Edison. Hand explained:

When, therefore, an agent is selected, as was Fuller, to engage singers for musical recitals, the customary implication would seem to have been that his authority was without limitation of the kind here imposed, which was unheard of in the circumstances.<sup>73</sup>

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63. *Kidd v. Thomas A. Edison, Inc.*, 239 F. 405 (S.D.N.Y. 1917).

64. *Id.* at 405.

65. *Id.*

66. *See id.* at 406.

67. *See id.*

68. *See id.* at 405–06.

69. *Id.* at 405.

70. *Thomas A. Edison, Inc. v. Kidd*, 242 F. 923 (2d Cir. 1917).

71. *Id.* at 924.

72. *Kidd*, 239 F. 405 at 406–08.

73. *Id.* at 406.

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Therefore it is enough for the decision to say that the customary extent of such an authority as was actually conferred comprised such a contract. If estoppel be, therefore, the basis of all 'apparent authority,' it existed here.<sup>74</sup>

Having apparently decided the case plausibly enough, however, Hand dismisses his reasoning and begins a truly interesting argument (dicta or the real holding?) worth quoting at some length:

Yet the argument involves a misunderstanding of the true significance of the doctrine, both historically . . . and actually. The responsibility of a master for his servant's act is not at bottom a matter of consent to the express act, or of an estoppel to deny that consent, but it is a survival from *ideas of status*, and the imputed responsibility congenial to earlier times, preserved now from motives of policy. While we have substituted for the *archaic* status a test based upon consent, i.e., the general scope of the business, within that sphere the master is held by principles quite independent of his actual consent, and indeed in the face of his own instructions. . . . It is only a fiction to say that the principal is estopped, when he has not communicated with the third person and thus misled him.<sup>75</sup>

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However it [the contention that vicarious liability is based on an estoppel of the employer] may be of contracts, all color of plausibility falls away in the case of torts . . . .<sup>76</sup>

Hand thus baldly states that the liability of masters for servants is not really a matter of consent or even estoppel but is instead derived from archaic notions of status. As Hand knew, in Roman law and elsewhere the head of the household is responsible for the acts of his immediate family, dependents, servants, and slaves. Thus, Hand obliquely claimed the operation of law, in contemporary society, that included slavery—this from a man born a few years after the Civil War who remembered veteran's tales. Hand just as surely knew that in the United States of 1917, the law of persons was hardly *passé*—racial status determined a great deal as a matter of law and women did not have the right to

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74. *Id.* at 407.

75. *Id.*

76. *Id.*

vote. None of this could have been very comfortable for Hand who thought of himself as progressive.<sup>77</sup>

Hand's problem, then, was to find new wine for the old bottles, new content for old doctrines. Edison should be liable on its contract with Kidd; Edison's vicarious liability is based on Edison's status as employer, "master." But why? It is not clear how to read Hand here. He seems to genuinely believe Maine's notion of social progress—of modernity—as the historical shift from social relations based on status, especially birth, to relations based on contract, or at least acts for which the individual may be held responsible. But at the same time, Hand insists that the vicarious liability of an employer is fundamentally based on status as an employer.

Hand attempts to solve this problem by arguing that the doctrine of apparent authority is both convenient and intrinsic to modern life. In delegating authority to an agent, a principal necessarily grants the agent some discretion. Granting the agent discretion to carry on the principal's business entails vouching for the agent's reliability to third parties. If principals did not vouch for the reliability of their agents, then third parties would have to ask principals whether the agent was in fact authorized to conduct the business at hand, and the very purpose of delegation would be defeated.<sup>78</sup> So within the "scope of employment," the principal is liable for the actions of the agent: "Once a third person has assured himself widely of the character of the agent's mandate, the very purpose of the relation demands the possibilities of the principal's being bound through the agent's minor deviations."

Note that Hand's justification for vicarious liability for agents acting with apparent authority is not based on contract but instead is derived from social practice. Hand assumes the social reality of corporate delegation, and argues that for delegation to work and business to get done, principals must be responsible for their agents. This is "theory" in the sense of social criticism, but it carries little normative weight. Hand's account does not explain why society should have large enterprises that rely on delegation, nor does it justify the delegation. Rephrased, for Hand "agency" is a structural account or description of a social practice, in fact, the practice of corporate life. Hand's project is thus diametrically

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77. See generally GERALD GUNTHER, *LEARNED HAND: THE MAN AND THE JUDGE* (1994); see also Richard A. Posner, *The Learned Hand Biography and the Question of Judicial Greatness*, 104 YALE L.J. 511, 529 (1994) (reviewing GUNTHER, *supra*).

78. See *Kidd*, 239 F. 405. At least sometimes, such as when closing a significant transaction, it can be quite difficult to ask "the corporation" whether a given action is authorized, involving resolutions of the board of directors, certified copies of the minutes, secretary's certificates, managerial signatures, and so forth.

opposed to theories of the firm based on agency. Rather than establish the institution of the corporation on the foundation of agency law, Hand assumes the existence of large firms in order to articulate a theory of vicarious liability under agency law.

There is much to be said on behalf of this approach to theory, but if our anxiety is about firms as such—about their use of power and their place in society—Hand's effort clearly does not suffice. One might say that the sugar economies of eighteenth-century Caribbean colonies, or the cotton economies of nineteenth-century American states presumed the existence of slave labor, and hence a law of slavery was to be expected, even if in tension with other aspects of the legal fabric. Understanding the logic of a social practice, and its legal consequences, does not necessarily justify the practice itself.

As Hand recognizes, third parties rely on the notion that the corporation delegates to or, conversely, controls its employees. That is, third parties recognize hierarchical relationships, relationships of status, and do business accordingly. But this is to say that, despite society's anxieties about status, business requires the establishment of hierarchies, and, therefore, status. Thus, it is not so clear how far Hand has brought the argument: anxieties about (premodern) status are supposed to be relieved by (modern) perceptions that labor is under control, regulated by the profit-interest of capital? Presumably, liberals take some comfort in the idea that status, in the business context, is not derived from birth, at least not explicitly or directly.

It is also not clear that Hand has it quite right. While his argument seems logically sound, the vicarious liability of principals does not seem in social fact to be based on the necessity of delegation or, more broadly, convenience—at least not always.

Another classic teaching case, *Ira S. Bushey & Sons v. United States*,<sup>79</sup> involved a U.S. Coast Guard ship, the *Tamoroa*, which was on blocks in a drydock in Brooklyn for repairs.<sup>80</sup> During the repairs, the crew slept on the ship, but they were free to go into the city and get very drunk.<sup>81</sup> Returning to the ship late one night, “in the condition for which seamen are famed,” a sailor named Lane opened the valves of the drydock.<sup>82</sup> Water flooded into the dock; the *Tamora* began to list; the ship was evacuated; the ship fell; nobody was hurt; property damage was

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79. *Ira S. Bushey & Sons v. United States*, 398 F.2d 167 (2d Cir. 1968).

80. *Id.* at 168.

81. *See id.*

82. *Id.*

done.<sup>83</sup> Ira S. Bushey & Sons successfully sued the United States for damages.<sup>84</sup>

On appeal, the United States argued that Lane was not acting within the scope of his employment.<sup>85</sup> The Second Restatement of Agency maintained that a servant's act, in order to be considered within the scope of employment, had to be "actuated, at least in part, by a purpose to serve the master." Judge Friendly conceded that

[it] would be going too far to find such a purpose here; while Lane's return to the Tamaroa was to serve his employer, no one has suggested how he could have thought turning the wheels to be, even if—which is by no means clear—he was unaware of the consequences.<sup>86</sup>

In an early judicial application of modern "law and economics" thinking, the district court had imposed liability on the United States with the rationale that this was the more efficient rule and would induce the United States to be more careful in whom it hired.<sup>87</sup> Judge Friendly was skeptical. Lane had no record of misbehavior and "the proclivity of seamen to find solace for solitude by copious resort to the bottle while ashore has been noted in opinions too numerous to warrant citation."<sup>88</sup> Besides, perhaps it would be cheaper and more effective for the drydock owner to install locks on the valves.<sup>89</sup>

Instead of efficiency, Friendly opined, the rule of *respondeat superior* is based on "a deeply rooted sentiment that a business enterprise cannot justly disclaim responsibility for accidents which may fairly be said to be characteristic of its activities."<sup>90</sup> So the question was whether Lane's actions were, broadly speaking, "risks characteristically attendant upon the operation of a ship."<sup>91</sup>

The language of tort seems unavoidable, and Friendly confusingly introduces the concept of "foreseeability," but tort—negligence—is not at issue.<sup>92</sup> The Coast Guard was not negligent in hiring Lane, who had no record of misbehavior. At the same time, as noted, it is certainly foreseeable that sailors will drink too much. And it is foreseeable that sailors,

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83. *Id.*

84. *Id.*

85. *Id.* at 170.

86. *Id.*

87. *Id.* at 170.

88. *Id.* at 172.

89. *See id.* at 170.

90. *Id.* at 171.

91. *Id.*

92. *See id.* at 171–73.

returning (as ordered) to a ship in drydock, may do some damage to the drydock. "Once all this is granted, it is immaterial that Lane's precise action was not to be foreseen."<sup>93</sup> "The foresight that should impel the prudent man to take precautions [negligence] is not the same measure as that by which he should perceive the harm likely to flow from his long-run activity in spite of all reasonable precautions on his own part."<sup>94</sup>

Foreseeability, then, comes down to what may reasonably be expected from operating an enterprise, in this case, a ship. What accords with common experience? At this juncture, we are back to custom and tradition—and *Watteau v. Fenwick*. Quoting Judge Andrews on judging, Friendly closes by saying, "[W]e endeavor to make a rule in each case that will be practical and in keeping with the general understanding of Mankind."<sup>95</sup> By this point, it is completely unclear that contract, in the sense of an arrangement reached by autonomous individuals, has anything much to do with an employer's liability for the action of its agent.<sup>96</sup>

But if agency law is not really about consent—or cannot be reduced to consent—then a corporation law founded on agency law cannot really be reduced to consent either.

#### V. CONCLUSION: TOWARD WARMER HORIZONS

The real problem with a consensual understanding of the corporation is that contract elides and obscures the social. This blindness toward the social character of commercial life raises two notable problems for political economy. First, in a world of status and rank, one might speak of the moral responsibility that attends privilege. In a world of contract—contract and nothing else—duties are bargained and paid for, and the parties are to reduce the scope of their obligations to others at every opportunity, thereby increasing their profits. The consequences of such a worldview are increasingly familiar. So it is said that the rich in America are rich because they deserve to be. Good fortune, a privileged position, must be evidence of one's value. This is observed most clearly in the now routine discussions of executive pay—that which is bargained for must be compensation. The responsibilities of those elected by markets extend to the terms of their contract; anything more is vanity. In short,

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93. *Id.* at 172.

94. *Id.* at 171.

95. *Id.* at 172 (quoting *Palsgraf v. Long Island R.R. Co.*, 162 N.E. 99, 104 (1928) (Andrews, J., dissenting)).

96. *See also* *Menard, Inc. v. Dag-MTI, Inc.*, 726 N.E.2d 1206 (Ind. 2000) (holding that a corporation was bound by the promise of its president to sell land, despite unfulfilled requirement of board approval).

elites in a world of pure contract do not even understand themselves as predatory, and business life becomes an unbridled celebration of egoism. This might be merely amusing except for the fact that corporate resources are routinely used to entrench positions, both vis-à-vis shareholders and society at large.

Cardozo insisted that responsibility could not be limited to contractual duties. Specifically, fiduciary duties are “something *stricter* than the morals of the marketplace.”<sup>97</sup> That “something stricter” is derived not from contract but from one’s status as a fiduciary, a person responsible for others. While it must be said that the restatement’s definition of “agency” is as “a fiduciary relationship,” the thrust of modern agency law is consent. This is not surprising: it is contract that moderns have traditionally used to bridge the gap between a commitment to equality and democracy, on one hand, and the reality or even necessity of hierarchical relations in human affairs on the other. But consent (contract), divorced from tradition, does not require the responsible exercise of power by the elites who possess it.

The second deep problem with the fear of the social enabled by the agency theory of the firm, based on consent, is if anything more unfortunate: if the corporation is merely a web of contracts, then it is all too easy to confuse the institutions of our markets with the individuals who participate in those markets, like the Supreme Court does in *Citizens United*. From such a stance, it is difficult to think seriously about the kinds of markets this society should have; political economy will continue to be conducted by forfeit. Modern agency law, with its squeamishness about status and power, obscures political thinking about the economy when it is most necessary. Meanwhile, real inequality in the United States grows by almost any measure. It is high time to admit that these are our traditions, our hierarchies, and our order. To use agency law to deny their existence is to obstruct serious consideration of the sorts of justice that may be available to us.

From this perspective it is a fine thing that modern agency law fails to provide a cogent theory of the firm. As also discussed above, however, modern agency law, characterized by a focus on the contracting individual, and conversely, horrified by the social, should not be taken too seriously.<sup>98</sup> Agency law, as restated by the American Law Institute, is a polite language, and while manners are not to be despised, by their very nature they do not tell the whole story.

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97. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

98. See *supra* Part IV.

But what if agency law, the law through which we articulate employment and other hierarchical relationships in the real economy, were to be reconsidered? What if agency relations were to be discussed in terms of the social, that is, if status, custom, and hierarchy were acknowledged to matter in business relations? Would a more worldly understanding of agency help us to understand the firm? How might one begin to rethink agency, and hence the corporation, in more social terms?

Recall that as principal the corporation is a source of authority, a focal point, the object of service and fiduciary duty, and a horizon for action, the Church incorporeal, or perhaps a *telos*, or in language more familiar to business life, a mission or purpose. While hardly the consensual language of contemporary agency law, understanding a business in terms of its purpose is quite familiar. Indeed, from a business perspective, as opposed to a jurisprudential perspective, it is completely natural to understand a company in terms of what it is trying to do, or it is said, where the company is trying to go. Rephrased, actual firms with businesses (as opposed to “the firm” in the abstract) generally have horizons. Once upon a time, the company’s horizon frequently was the horizon on the ocean: companies were formed to go sailing to spice islands. Today, it is less romantically said that the corporation’s future is articulated by the business model, whatever the substance of that model might be. The empty vessel provided by corporate law, “all lawful purposes” in the language of a charter, is filled or specified by business practice, often expressed by a mission statement and financing documents.

Some horizon is necessary (logically entailed) in the idea of official action, and therefore in bureaucracy, regardless of the specific purpose or capital structure of the institution. One may serve a corporation’s mission (grandiosely: “Let’s build a smarter planet.”).<sup>99</sup> One may serve the environment (the EPA) or the investor (the SEC). But without an object of service (devotion), one’s action cannot be characterized as selfless and therefore cannot be “official,” defined in terms of one’s position on some organizational chart. One cannot have a business purpose without a business distinct from the self. One cannot even be a good agent.

Directors and managers owe fiduciary duties to the enterprise, meaning they are to avoid conflicts of interest, to put the interests of the enterprise above their own. Agents owe similar duties to their principals, the companies for which they work. Even the supposedly self-interested investor, the rational shareholder, must subordinate her immediate interests to a speculative vision of the future; she must postpone gratification

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99. IBM’s current, stunningly authoritarian, advertising campaign.



in the hope of living long enough to enjoy the return on her investment. Thus, the corporation is not ultimately about the self, as modern agency avers, but about risking the self in order to achieve something new and big, an adventure, as Cardozo has it.<sup>100</sup>

The institution of the corporation, understood to be a bureaucratic entity, entails a horizon for the institution, and thereby the orientation of people and the formation of the sort of cohesive array of persons recognizable as an institution. So horizons—collective journeys as yet unmade—organize participation in the corporation and constitute the souls of the institutions that collectively form civil society, the warp of lives.

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100. Cardozo speaks of Meinhard and Salmon as “coadventurers.” *Meinhard*, 164 N.E. at 462.